No. 4358

United States

Circuit Court of Appeals

For the Ninth Circuit

In the Matter of SUN DRUG COMPANY, Bankrupt,

R. L. SABIN, as Trustee in Bankruptcy of the SUN DRUG COMPANY,

Petitioner,

vs.

ACME INVESTMENT COMPANY, a Corporation,

Respondent.

Respondent's Brief

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STATEMENT OF FACTS

Acme Investment Co. leased to Sun Drug Co. the premises at 351 Washington Street, Portland, Oregon, for a ten year period beginning February,

1923, at a monthly rental of $1045.00 for the first five years and $1195.00 for the last five years of the term; the total rentals aggregating $134,400.00.

At the time of making said lease and in consideration of the execution thereof the Lessee paid the Lessor Five Thousand ($5,000.00) Dollars in cash and delivered its promissory note in the sum of Sixteen Hundred ($1600.00) Dollars due April 15th, 1923, bearing interest at six per cent. (6%), said note never having been paid. On July 28th, 1923, owing to the failure of Lessee to pay the June or July rent, Lessor served notice of cancellation of lease, but continued to treat the lease as in full force.

Thereafter and in September, 1923, the Lessee filed a voluntary petition in bankruptcy and was adjudicated a bankrupt.

The Lessor filed a claim against the Trustee in the sum of $977.60 for rent accruing during the time the Receiver and Trustee were in possession of the premises. The Trustee objected to allowance of said claim on the theory that the $5,000.00 paid by the Lessee to the Lessor at the time of the execution of the lease constituted a deposit as security for the lease which should be applied in payment of the rent accruing during the time the Receiver and Trustee were in possession of the premises.

That part of the lease referring to the payment of said $5,000.00 reads as follows:

> "Now therefore, in **consideration of the sum of Five Thousand ($5,000.00) Dollars in cash,** and the promissory note of the Lessee in favor of Lessor due April 15th, 1923, in the sum of Sixteen Hundred ($1600.00) Dollars, the receipt of said cash and note being hereby acknowledged by the Lessor, and in further consideration of the rentals herein reserved, and of the covenants herein contained, on the part of the Lessee to be paid and to be kept and faithfully performed by it, said Lessor does hereby lease, etc."

In no other part of the lease is the said $5,000.00 mentioned. The words "Deposit" or "Security" do not appear in the lease, nor is there any provision for the payment of interest on said sum to the Lessee. The $1600.00 note provides for the payment of six per cent. (6%) interest by Lessee.

The Referee held that the $5,000.00 cash and the $1600.00 note given by Lessee to Lessor at the time of making the lease did not constitute a consideration, bonus, or inducement for the execution of the lease, but was a payment given to secure the faithful performance of the lease; that therefore title thereto did not pass to the Lessor, but became assets of the bankrupt, Lessee's estate.

Thereafter the Lessor, Acme Investment Co., filed a petition to review the order of the Referee, and the District Court of the United States for the District of Oregon made an order reversing the order

of the Referee and directing the Trustee to pay the claim for rent.

QUESTION INVOLVED

The sole question for decision in this matter is whether the said sum of $5,000.00 so paid by Lessee to Lessor at the time of the making of the lease is to be considered a deposit for rentals due or to become due under the lease, or whether it is to be deemed money paid as a consideration or bonus for the execution of the lease. If it be a deposit, the money belongs to the Lessee, being merely held in trust by the Lessor for him. But, if instead of a deposit it is money paid as consideration or bonus for the execution of the lease, then title thereto immediately passed to the Lessor and it is the absolute owner thereof, without any claim or interest therein either in favor of the Lessee or the Trustee in Bankruptcy.

ARGUMENT

In determining the question in issue it is necessary to consider the language of the lease so far as it relates to said payment of Five Thousand ($5,000.00) Dollars, because the lease speaks for itself and shows the expressed intention of the parties. As stated by Judge Bean, the lease is plain and unambiguous. It is elementary that all prior negotiations respecting the lease are merged in the written instrument and that parol evidence is inadmissible to alter, vary, or contradict its terms.

No testimony was taken either before the Referee or the District Judge. The Referee in his decision states that in a preliminary oral arrangement had between the Lessee and a rental broker representing the Lessor, the rental for the term was agreed upon at $141,000.00, but that before the lease was signed the Lessor required $6,600.00 to be paid it as consideration therefor, and only exacted rentals during the period of the lease aggregating $134,-400.00; that by reason thereof the money paid at the time of the execution of the lease as consideration therefor, and so acknowledged to be such in the lease, was in reality a deposit. The Referee also says that it was conceded that such arrangement was to secure to the Lessor the faithful performance of the lease. If the Referee means by his language to say that the Lessor insisted on this arrangement to protect its interest, he is correct, but if he means to convey the impression that the Lessor intended that the initial payment made at the time of the execution of the lease was to be a deposit or security for the lease, he is decidedly in error. Neither the Lessor nor its attorneys have ever stated or admitted that the initial payment was inended as security or as a deposit, but have always insisted and do now insist that the lease as drawn contains and correct statement of the final agreement of the parties.

The Referee, in his decision, entirely ignored the language of the lease, which is plain and unambig-

uous, and preceeds to set up as the alleged true and real agreement of the parties, not the formal document to which they attached their signatures, but the preliminary oral arrangement had between the rental broker and the Lessee.

If the rule adopted by the Referee were to be upheld, it would be useless to go through the formality of drawing up or executing written instruments. They would indeed become scraps of paper. Every person, when it was his advantage so to do, would claim that the written contract he signed did not contain a true statement of his agreement, but that something else was intended. The sanctity which the law has thrown around written instruments, based on generations of experience, would be destroyed, and written instruments would cease to exist.

The ruling of the Referee, however, is not the rule followed by the Supreme Court of the United States. See Northern Assurance Co. vs. Grand View Building Co., 183 U. S. 308.

The Referee based his right to set aside the formal document executed by the parties and to substitute therefor the preliminary oral arrangement or talk had between the Lessee and the rental broker, on the strength of three Oregon decisions, to-wit:

Alford v. Banfield, 85 Ore. 49,
Moumal v. Parkhurst, 89 Ore. 248,
Yuen Suey v. Fleischman, 65 Ore. 606.

We beg to submit that even a cursory examination of said cases will disclose that they do not support the Referee's decision. They are cases involving leases in which money was deposited as security for the payment of rent and providing that in event of default and cancellation of the lease the money so deposited should be retained by the Lessor as liquidated damages for breach of lease. The Court held it could be shown that the retention of the deposit was in reality a penalty, notwithstanding the lease denominated such retention as liquidated damages. This is a mere application of a universal rule of law.

In the present case there is no question of either "penalty" or "liquidated damages" nor are either words used in the entire lease. In the Oregon cases mentioned the words "deposit" and "as security for the payment of rent" were employed, and the lease further provided in each case for the payment of interest on said "deposit" and provided for the credit of the amount of said deposit as rental at the end of the term. These cases, we submit, have no bearing or application whatever on the issues of law raised in this case.

A careful review of the Digests discloses that there are no decisions by the Supreme Court of Oregon involving a situation similar or analogous to the present case where money is paid by the Lessee to the Lessor at the time of and as consideration for the execution of the lease.

This precise case, however, has been presented to other Courts for decision as we shall hereinafter show, and in all cases where money has been paid by the Lessee to the Lessor in consideration of the execution of the lease, the courts have uniformly held that such money constitutes a payment to the Lessor fully earned by the Lessor by the execution of the lease, and they have consistently refused to hold such payment as a deposit or security for the lease, or to recognize that the Lessee has any claim to or interest therein.

We beg to submit the following authorities as sustaining the doctrine we are herein contending for:

Dutton vs. Christie, 115 Pac. 856 (Wash.)
Barrett vs. Monro, 124 Pac. 369 (Wash.)
Ramish vs. Workman, 164 Pac. 26 (Cal.)
Curtis vs. Arnold, 184 Pac. 510 (Cal.)
Galbraith vs. Wood, 144 N. W. 948 (Min.)
Forgotston vs. Brafman, 84 N. Y. S. 237.
Ann. Cas. 1915 B Note, Page 613.
50 L. R. A. (N. S.) 1034.
16 R. C. L. 931.
36 C. J. 296.

In Dutton vs. Christie the Lessees under a written lease paid the Lessor the sum of $1500.00 upon the execution of the lease, which payment was covered by the following paragraph embodied in the lease:

> "In consideration of the covenants of the second parties (the Lessee) hereinafter set forth, and of the sum of $1500.00 now paid to the first parties by the second parties, receipt of which is hereby acknowledged."

and in a subsequent paragraph of the lease it is stipulated,

> "That the above payment of $1500.00 now made shall, in the event of full and faithful performance of this contract by the second parties, be credited as payment of rent for the last two months of the term."

Later and in the following year the Lessees being in arrears of rent moved out of the premises and the Lessors retook possession. In the litigation that followed for the collection of rent in arrears by the Lessor, the Lessee contended that this sum of $1,-500.00 which was paid in advance was intended as a deposit in the nature of a penalty for any failure on their part to carry out the terms of the lease; that to allow the landlord to retain this money and at the same time have judgment for rent in arrears would be to enforce a forfeiture or penalty, and demanded that this sum should be treated as a set off against the landlord's claim for rent in arrears, which would leave a balance in their favor of $439.10. The Court in an able decision by Ellis J. held for the landlord and against the Lessee. The facts being so similar to those of the instant case it is deemed best to quote from said opinion somewhat at length:

"We cannot agree with this contention without in effect writing a new contract for the parties."

"In the beginning of the lease the parties have declared that the lease is given in consideration of the covenants of the second parties and of the payment of $1500.00. The lease was certainly a legally sufficient consideration for the payment. If there had been no further mention of this money, there could be no question of the landlord's ownership of it. Do you think the added stipulation that this payment shall, in the event of full performance of the contract by the second parties, be credited in payment of the rent for the last two months of said term, but otherwise said payment this day made shall belong to the first parties as a part of the consideration to them for the execution of this lease . . . . change the nature of this payment from consideration to penalty. We think not. It is declared to be a part of the consideration in the beginning, and this clause reiterates the same thing. In both instances the ownership of the respondent therein is affirmed. This is not changed but an agreement to apply this sum in payment of the rent for the last two months of the term in the event of the appellants (Lessees) fully performing their contract. It was only by that

performance that they could assert any claim on this money. They must earn it."

"The fact that the respondent (the Lessor) was willing to forgo $1500.00 of the consideration of the lease in order to encourage the faithful performance of their covenants by the Lessees, is no good reason, either in law or in morals for penalizing **him** in that amount for **their** failure to perform."

"The money was not deposited as security. There was merely a stipulation that it should be applied as payment of rent upon a condition which has never been performed. There is a manifest difference between a deposit for security and a stipulation for a reduction of consideration upon contingency."

"When the appellants paid this money as a consideration for the lease, the title to it passed to the respondent. Their breach of the lease cannot divest this title."

In the case of Ramish vs. Workman, Supra, involving a lease for a ten year period, the lease recited that the lessees paid to the lessor "As further consideration for this lease in addition to the rent herein reserved the sum of $7200.00" and "That if lessees shall pay the rent herein reserved when the same becomes due hereunder and shall well and truly perform and observe all the covenants and agreements herein contained on their part to be performed and reserved during the first nine years

seven months and twelve days of this lease, and this lease shall not be terminated by the re-entry of the lessor as hereinafter provided within said period of nine years, seven months and twelve days, he will credit the sum of $7200.00 hereinafter provided to be paid to him by the lessees upon the last four months and eighteen days rent under this lease."

Default having been made in the payment of rent, the lessor obtained possession of the premises by an F. E. D. action and then filed an action for back rent.

The lessee filed a counterclaim alleging that the $7200.00 paid when the lease was executed constituted a deposit which should be returned to the lessee after deducting accrued rent.

The Court held that the $7200.00 was not a deposit, but was a payment made in consideration of the execution of the lease which belonged to the lessor absolutely, and that the lessee had no interest therein.

In the course of its opinion the Court said:

> "Appellant's chief ground for reversal, and upon which they devote much of their argument, is based upon the provision of the lease pursuant to which they paid plaintiff $7200.00, claim to which is asserted in both the answer and cross-complaint. Notwithstanding the plain language in which the provision is couched, the meaning of which, to our minds,

admits of no controversy, they insist that it should be construed as security for the payment of the rent reserved during the time ending with their eviction and any damages sustained by the plaintiff; that when the landlord elected to evict defendants from the premises for nonpayment of rent he waived all claim to the $7200.00, except in so far as it was necessary to apply it in payment of rent then due or accrued. As stated in Dutton v. Christie, 63 Wash. 373, 115 Pac. 857, where a similar question was involved: 'We cannot agree with this contention without in effect writing a new contract for the parties.'

"Clearly the $7200.00 was paid for a ten-year lease of the premises, upon the conditions and terms specified therein. Defendants parted with the money, not as a penalty or as security, but as a payment the consideration for which was the execution of the lease on the part of plaintiff. The title thereto passed absolutely to the lessor, unaffected by the fact that he agreed, upon the performance of certain conditions by defendants, to give them credit therefor. The conditions were never performed by defendants, and hence they could have no claim to the fund. The authorities which appellants cite in support of their contention all appear to have been cases where the deposits was made with the lessor upon the

execution of the lease as security for the payment of the rent, and in such cases, upon the lessor evicting the tenants, it is uniformly held that he cannot assert claim to the amount so deposited, over and above rent due, with damages sustained. The cases cited by appellants involve deposits made as "a guaranty," as "a penalty," "for security", etc., and hence are readily distinguished from the case at bar. This view finds full support in the case of Dutton v. Christie, Supra."

"The provisions of the lease in question hereinbefore quoted should be interpreted in accordance with the plain import of the language used, and, thus construed, it is clear that the parties intended the $7200.00 to be in the nature of a bonus or additional consideration paid the Lessor as an inducement to make the lease upon the terms and conditions therein contained; and, as stated, the fact that upon the performance of all the covenants and agreements contained in the lease to be performed by the lessors during the first nine years, seven months and twelve days of the term thereof he promised in effect to release them from the payment of rent at the rate of $1500.00 per month for the last four months and eighteen days of the term so demised furnishes no reason for appellants' contention."

A case directly in point is the case of,—In Pil-

chard Motor Car Co., Bankrupt, decided by Judge Wolverton of the United States District Court for the District of Oregon in memorandum opinion in the Spring of 1924.

In the Pilchard Motor Car Case involving a lease for a term of years at a rental of $500.00 per month, the sum of $2,000.00 was paid by the Lessee to the Lessor at the time of the execution of the lease and as consideration therefor. The lease provided that if Lessee duly complied with the terms of the lease, the rent for the last four months would be $1.00 per month. After the Lessee was adjudicated bankrupt the Trustee claimed that the money so paid to the Lessor by the Lessee as consideration for the execution of the lease was intended to be and constituted a deposit as security for the rent, title to which did not pass to the Lessor, and that said money constituted assets of the bankrupt's estate. Judge Wolverton cited several of the cases hereinbefore mentioned and held that the language of the lease governed and that as the lease recited that it was paid as consideration for the lease, the money belonged to the Lessor and was not a deposit as security for the lease. The Referee, in his decision, makes no reference to the Pilchard Motor Car Case, but attempts to differentiate this case from it because in that case the $2,000.00 paid by the Lessee to the Lessor at the date of entering into the lease was paid as consideration for the rental of premises on which the Lessor agreed to construct a building which the Lessee was to occupy.

Manifestly when money is paid as consideration for the execution of a lease, the legal effect of such payment is the same whether the Lessor leases a building already erected or leases a building to be thereafter constructed by him.

As a matter of interest, nearly all the cases we have cited in this brief involve the leasing of a building already completed.

The cases cited herein fully sustain the doctrine of law we are contending for, and as a matter of fact a careful research of all the authorities discloses no case holding a contrary doctrine.

Counsel for petitioner argues that the lease is not plain and unambiguous because it does not say that $5,000.00 was **paid** to the lessor. The lease expressly acknowledges receipt of the money by the lessor, and recites that it is **received** by the lessor **as consideration for the execution of the lease.** We do not see how words could make the language and meaning of the lease any plainer or clearer.

Counsel for petitioner, on pages 15 and 16 of his brief, submits a query. He says: "Suppose that at the time of the execution of the lease the Lessee had paid Lessor $5,000.00 as consideration for the lease and had also at the same time and pursuant to its terms paid the first year's rental in advance, and that five months thereafter the Lessor on account of some violation of the lease by the Lessee and for just cause had terminated the lease."

"What right," he asks, "would the Lessor have to retain the advance rent paid him for the remaining seven months of the first year?"

We submit that in our opinion the Lessor could retain the advance rent for the remaining seven months just exactly as he could if no money had been paid him as consideration for the execution of the lease.

In other words,—we believe that if a tenant rents a place for one year and pays the full years' rent in advance pursuant to the terms of the lease, and thereafter before the expiration of the year violates the covenants of the lease justifying a re-entry by the landlord, and the landlord does make a re-entry, he is not required by law to make a refund to the tenant for the remainder of the year.

This precise question was decided by the Supreme Court of Minnesota in Galbraith vs. Wood, 144 N. W. 945, where the Court uses the following language:

> "Where rent has been paid in advance under an agreement that it shall be so paid, and the Lessor re-enters for condition broken, he is entitled to retain the rents so paid, though the re-entry is before the expiration period for which the rent is paid."

In the course of his decision the Referee states that it is an injustice to permit the Lessor to retain the $5,000.00 paid as consideration for the lease,

and also to collect the stipulated monthly rental during the time the Lessee occupied the premises. As a matter of fact the Lessor did not collect rent for the two months preceding the bankruptcy of the Lessee, and the premises were vacant for some time after the Trustee surrendered the premises. Thereafter the Lessor leased the premises at a much lower rental to a new tenant. The truth is,—that instead of profiting by the bankruptcy of the Lessee, the Lessor sustained considerable loss.

The landlord has the right to safeguard his interests. We submit that he can lease his property or not as he sees fit, and on such terms as he may impose. He can exact a bonus or consideration for the execution of a lease, or he can charge any rental, whether the same be exorbitant or inadequate, and if the Lessee accepts his terms, such contract is binding. Owing to just such situation as resulted from the bankruptcy of the Sun Drug Co., owners of valuable property attempt to protect themselves against loss. To this end various methods are used in drawing leases. Some require an amount to be paid as consideration for the execution of the lease. Others require several times the actual rental value for the first month or so. In all cases credit is given the Lessee, generally,—by making the rental of the last several months of the term $1.00 (Pilchard Motor Case) or rent free (Dutton v. Christie), and sometimes the money is absorbed by spreading the credit over the entire term.

In conclusion we beg to submit that the order of Judge Bean of the District Court should be affirmed.

Respectfully submitted,

BRICE & BRAZELL,
Attorneys for Respondent.